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Internal Revenue Service

Publication 504

Tax Information for Divorced or Separated Individuals

For use in preparing
1989 Returns

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Introduction

This publication explains certain federal tax rules that may affect your tax liability if you are divorced or separated from your spouse. The publication covers filing status, dependency exemptions, and the treatment of alimony and property settlements.

Free Publications and Forms

If you need information on a subject not covered in this publication, you may check our other free publications. To order publications and forms, call our toll-free telephone number 1-800-424-FORM (3676) or write the IRS Forms Distribution Center for your area as shown in the income tax package.

Filing Status

Your filing status affects your filing requirement, standard deduction, and correct tax. It may also determine whether you can claim certain deductions and credits.

Your marital status is important in determining your filing status. Whether or not you are married is determined on the last day of your tax year.

If you are considered unmarried, your filing status is single or, if you meet certain requirements, head of household. If you are considered married, your filing status is either married filing a joint return or married filing a separate return. If both you and your spouse have income, you should usually figure your tax on both a joint return and separate returns to see which gives you the lower tax.

Considered unmarried. You are considered unmarried for the whole year if either of the following applies.

- 1) You have obtained a final **decree of divorce** or **separate maintenance** by the last day of

your tax year. You must follow your state law to determine if you are divorced or legally separated.

Exception. If you and your spouse obtain a divorce in one year for the sole purpose of filing tax returns as unmarried individuals, and at the time of divorce you intended to remarry each other and did so in the next tax year, you and your spouse must file as married individuals.

- 2) You have obtained a **decree of annulment**, which holds that no valid marriage ever existed. You also must file amended returns claiming unmarried status for all tax years affected by the annulment that are not closed by the statute of limitations. The statute of limitations generally does not end until 3 years after you filed your original return.

Considered married. You are considered married for the whole year if you are separated, but you have not obtained a final decree of divorce or separate maintenance by the last day of your tax year. An interlocutory decree is not a final decree.

Married living apart. Even though you are not divorced or legally separated, if you live apart from your spouse and meet certain tests, you will be **considered unmarried**, and can file as head of household. See *Head of Household*, later.

Joint Return

If you are married, you and your spouse may be able to file a joint return. If you file jointly, you both must include all your income, exemptions, deductions, and credits on that return. You can file a joint return even if one of you had no income or deductions.

To file a joint return, at least one of you must be a U.S. citizen or resident at the end of the tax year. However, if either of you was a nonresident alien at any time during the tax year, you can file a joint return only if you agree to treat the nonresident spouse as a resident of the United States. This means that your combined worldwide incomes are subject to U.S. income tax. See Publication 519, *U.S. Tax Guide for Aliens*.

Signing a joint return. Both you and your spouse must sign the return, or it will not be considered a joint return.

Joint liability. Both you and your spouse are responsible, jointly and individually, for the tax and any interest or penalty due on your joint return. This means that one spouse may be held liable for all the tax due even if all the income was earned by the other spouse.

Divorced taxpayers. If you are divorced, you are still jointly and individually responsible for any tax, interest, and penalties due on a joint return filed before your divorce. This responsibility applies even if your divorce decree states that your former spouse will be responsible for any amounts due on previously filed joint returns.

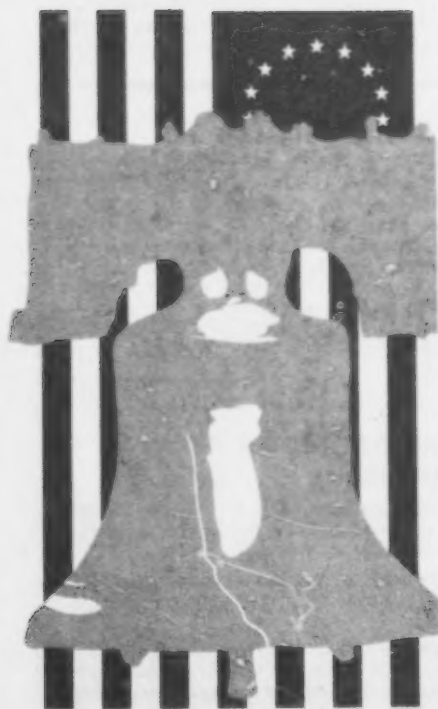
Exception. You may not have to pay the additional tax, interest, and penalties if the tax on your joint return was understated by more than \$500 because your spouse either:

- Omitted an item of gross income or
- Claimed a deduction, credit, or property basis for which there was no basis in fact or law.

To determine who omitted an item of gross income (other than income from property), do not apply community property rules.

To qualify under this exception, you must meet both the following requirements:

- You must establish that you did not know, and had no reason to know, about the tax understatement.



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It must be unfair, under all the facts and circumstances, to hold you liable for the additional tax, interest, and penalties.

A factor in determining that it is unfair to hold you liable is the absence of any significant benefit to you, either direct or indirect, from the understatement of tax. Your receipt of property from your spouse may be a significant benefit, even if it is received several years after the year of the tax understatement. Normal support is not a significant benefit.

In addition, if the tax understatement resulted from claiming a deduction, credit, or basis, the exception applies only if the additional tax, interest, and penalties are more than:

10% of your adjusted gross income (AGI) for the preadjustment year, if your AGI was \$20,000 or less, or

25% of your AGI for the preadjustment year, if your AGI was more than \$20,000.

Your **preadjustment year** is your most recent tax year ending before a deficiency notice was mailed. If you were married to a different person at the end of the preadjustment year, your AGI includes your new spouse's income, whether or not you filed a joint return for that year.

Tax refund applied to debts. If you are due a refund but have not paid certain debts, all or part of your refund may be used to pay the past-due amount. The debts that may be paid from your refund are child and spousal support payments and federal debts such as student loans.

Injured spouse. You can prevent your share of a tax refund on a joint return from being applied to a debt owed by your spouse by attaching a completed Form 8379, *Injured Spouse Allocation*, to the front of your return. If you do not attach Form 8379 to your return, you can later get your share of a refund that was applied to your spouse's debt by filing Form 1040X, *Amended U.S. Individual Income Tax Return*, with Form 8379 attached.

You are an **injured spouse** only if you meet all the following requirements:

You are not obligated to pay the debt.

You had income (wages, interest, etc.) that was reported on your joint return.

You had tax withheld, estimated tax payments, or a refundable credit that was reported on your joint return.

You had an overpayment that will be (or was) applied to your spouse's debt.

Separate Returns

If you and your spouse file separate returns, you should each report only your own income, exemptions, deductions, and credits on your individual return. You can also file a separate return if only one of you had income. For information on exemptions you can claim on your separate return, see *Exemptions*, later.

Community or separate income. If you live in a community property state and file a separate return, your income may be separate income or community income for income tax purposes. For more information, see *Community Income*, later.

Itemized deductions. If you and your spouse file separate returns and one of you itemizes deductions, the other spouse will not qualify for the standard deduction and should also itemize deductions.

Separate liability. If you and your spouse file separately, you each are responsible only for the tax due on your own return.

Separate returns may give you a higher tax. Some married couples file separate returns because each wants to be responsible only for his or her own tax. But in almost all instances, if you file separate returns, you will pay more combined

federal tax than you would with a joint return. This is because the tax rate is higher for married persons filing separately. The following rules also apply if you file a separate return:

You usually cannot take the credit for child and dependent care expenses.

You cannot take the earned income credit.

If you lived with your spouse at any time during the tax year—

- a) You cannot take the credit for the elderly or the disabled, and
- b) You will have to include in income one-half of any social security or equivalent railroad retirement benefits you received.

Joint return after separate returns. If you or your spouse, or both, file separate returns, you can change to a joint return any time within 3 years from the due date (not including extensions) of the separate returns. This applies even if the separate returns were filed as single or head of household. Use Form 1040X, *Amended U.S. Individual Income Tax Return*.

If the tax on your joint return is more than the total paid on your separate returns, you must pay the additional tax when you file Form 1040X.

Separate returns after joint return. After the due date of your return, you and your spouse **cannot** file separate returns if you previously filed a joint return.

Head of Household

You may be eligible to file as head of household if you meet the requirements discussed later. Filing as head of household has the following advantages:

You can claim the standard deduction even if your spouse itemizes deductions on a separate return.

Your standard deduction is higher than that allowed on a single or married filing separate return.

Your tax may be lower than that on a single or married filing separate return.

You may be able to claim certain credits you cannot claim on a married filing separate return.

Requirements. You can file as head of household only if you were unmarried or were considered unmarried on the last day of the year. You also must have paid more than half the cost of keeping up a home that was the main home for more than half the year (except for temporary absences, such as for school) for you and any of the following:

- 1) **Your unmarried child**, grandchild, stepchild, or adopted child. This child does not have to be your dependent. But a foster child must qualify as your dependent.
- 2) **Your married child**, grandchild, stepchild, or adopted child whom you can claim as your dependent, or whom you could claim as your dependent except that:

- a) By your written declaration you allow the noncustodial parent to claim the dependent, or
- b) The noncustodial parent provided at least \$600 for the support of the dependent and claims the dependent under a pre-1985 agreement.

- 3) **Any other relative** whom you can claim as a dependent. However, your dependent parent does not have to live with you (see *Father or mother*, later). For persons who qualify as a relative, see *Test 1—Relationship* under *Dependency Tests*, later.

You cannot file as head of household if you only claim a relative in (2) or (3), or a parent who did not live with you, as a dependent under a multiple support agreement (discussed later).

Father or mother. If your dependent parent does not live with you, you can file as head of household if you paid more than half the cost of keeping up a home that was the main home for the **whole** year for your father or mother. Keeping up the main home for your dependent parent includes paying more than half the cost of keeping your parent in a rest home or home for the elderly.

Considered unmarried. If you are married you will be considered unmarried if you meet all of the following tests:

You file a separate return.

You paid more than half the cost of keeping up your home for the tax year.

Your spouse did not live in your home during the last 6 months of the tax year.

Your home was, for more than half the year, the main home of your child, stepchild, adopted child, or foster child whom you can claim as a dependent, or whom you could claim as your dependent except that:

- a) By your written declaration you allow the noncustodial parent to claim the dependent, or
- b) The noncustodial parent provided at least \$600 for the support of the dependent and claims the dependent under a pre-1985 agreement.

Nonresident alien spouse. If your spouse was a nonresident alien at any time during the tax year, and you have not chosen to treat your spouse as a resident alien, you are considered unmarried for head of household purposes. However, your spouse does not qualify as a relative. You must have another qualifying relative and meet the other requirements to file as head of household.

Keeping up a home. You are keeping up a home only if you pay **more than half** the cost of its upkeep. This includes such costs as rent, mortgage interest, taxes, insurance on the home, repairs, utilities, domestic help, and food eaten in the home.

For more information on filing as head of household, see Publication 501, *Exemptions, Standard Deduction, and Filing Information*.

Exemptions

For 1989 you are allowed a \$2,000 deduction for each exemption you can claim. You can claim your exemptions whether or not you itemize deductions.

You can claim your own exemption unless someone else can claim you as a dependent. If you are married, you may be able to take an exemption for your spouse. You can take an exemption for each person who qualifies as your dependent under the dependency tests discussed later.

Exemption for Your Spouse

Your spouse is never considered your dependent. You can take an exemption for your spouse only because you are married.

Joint return. If you and your spouse file a joint return, you can claim an exemption for each of you.

Separate return. If you file a separate return, you can take an exemption for your spouse only if your spouse is not filing a return, had no gross income,

was not the dependent of someone else. This is even if your spouse is a nonresident alien.

Gross income. If you paid alimony to your spouse and deduct it on your separate return, you cannot take an exemption for your spouse. This is because alimony is gross income to the spouse who received it.

Former spouse. If at the end of the tax year you were divorced or legally separated under a final decree, you cannot take an exemption for your former spouse. This rule applies even if you paid for your former spouse's support.

Exemptions for Dependents

You can take an exemption for each person who is your dependent. A dependent is any person who meets all five of the dependency tests discussed below.

Life. If you can claim an exemption for your dependent, the dependent cannot claim his or her own exemption on his or her own tax return.

Social security numbers for dependents. If you have a dependent who is at least **2 years old** by the end of your tax year, you must list the dependent's social security number (SSN) on your Form 1040 or Form 1040A. If you do not list the dependent's SSN when required or if you list an incorrect SSN, you may be subject to a \$5 penalty.

Birth or death of dependent. You can take an exemption for a dependent who was born or who died during the year if he or she met the dependency tests while alive. This means that a child lived only for a moment can be claimed as a dependent. Whether a child was born alive depends on state or local law. There must be evidence of a live birth shown by an official document, such as a birth certificate. You cannot claim an exemption for a stillborn child.

Dependency Tests

A dependent must meet **all** the following tests:

- Relationship.
- Married person.
- Citizen or resident.
- Income, and
- Support.

Test 1—Relationship

A dependent must either:

- Be related to you or
- Have been a member of your household.

Related. If the dependent is not a member of your household, he or she must be related to you (or your spouse if you are filing a joint return) in one of the following ways:

Child	Great-grandchild, etc.	Brother-in-law
Parent	Half-brother	Sister-in-law
Grandparent	Half-sister	Son-in-law
Grandchild, etc.	Stepbrother	Daughter-in-law
Parent-in-law	Stepsister	If related by blood:
Stepchild	Stepmother	Uncle
	Stepfather	Aunt
	Mother-in-law	Nephew
	Father-in-law	Niece

Relationships that have been established by marriage are not considered ended by death or divorce.

Child. See **Test 4—Income**, later, for the definition of "child."

Member of household. If the dependent is not related to you, he or she must have lived in your home as a member of your household for the whole year (except for temporary absences, such as for vacation or school). A person is not a member of your household if at any time during your tax year the relationship between you and that person violates local law.

Test 2—Married Person

The dependent cannot have filed a joint return for 1989. However, if neither the dependent nor the dependent's spouse is required to file, but they file a joint return to get a refund of all tax withheld, you may claim the dependent if the other four tests are met.

Test 3—Citizen or Resident

The dependent must have been a citizen or resident of the United States, a resident of Canada or Mexico, or an alien child adopted by and living the entire year with a U.S. citizen in a foreign country.

Test 4—Income

The dependent must have received less than \$2,000 of gross income in 1989. Gross income does not include nontaxable income, such as welfare benefits or nontaxable social security benefits.

Special rules for your dependent child. The income test does not apply if your child:

- Was under 19 at the end of 1989 or
- Was a student during 1989 and was under 24 at the end of 1989.

Child. Your child is:

- Your son, daughter, stepson, stepdaughter, or adopted son or daughter.
- A child who lived in your home as a member of your family, if placed with you by an authorized placement agency for legal adoption, or
- A foster child (any child who lived in your home as a member of your family for the whole year, for whom you did not receive qualified foster care payments).

Student. To qualify as a student, your child must have been, during some part of each of 5 calendar months (not necessarily consecutive) during 1989:

- 1) A full-time student at a school that has a regular teaching staff and course of study, and a regularly enrolled body of students in attendance, or
- 2) A student taking a full-time, on-farm training course given by a school described in (1) above or a state, county, or local government.

A **full-time student** is one who was enrolled for the number of hours or courses the school considers to be full-time attendance.

The term "school" includes elementary schools, junior and senior high schools, colleges, universities, and technical, trade, and mechanical schools. It does not include on-the-job training courses, correspondence schools, or night schools.

Test 5—Support

In general, you must have given over half the dependent's support in 1989. If you file a joint return, the support could have come from you or your spouse. Even if you did not give over half the dependent's support, you will be treated as having given over half the support if you meet the tests explained later under **Multiple Support Agreement**.

If you are divorced or separated and you or the other parent, or both together, gave over half your child's support in 1989, the support test for your child may be based on special rules. See **Children of Divorced or Separated Parents**, later.

In figuring total support, you must include money the dependent used for his or her own support, even if this money was not taxable (for example, gifts, savings, welfare benefits). If your child was a student, do not include amounts he or she received as scholarships.

Support includes items such as food, a place to live, clothes, medical and dental care, recreation, and education. In figuring support, use the actual cost of these items. However, the cost of a place to live is figured at its fair rental value.

Do not include in support items such as income tax and social security tax, premiums for life insurance, or funeral expenses.

Joint ownership of home. If your dependent lives with you in a home that is jointly owned by you and your spouse or former spouse, and each of you has the right to use and live in the home, each of you is considered to provide half your dependent's lodging. However, if your decree of divorce gives only you the right to use and live in the home, you are considered to provide your dependent's entire lodging, even though legal title to the home remains in the names of both you and your former spouse.

Capital items. You must include capital items such as a car or furniture in figuring support, but only if they were actually given to, or bought by, the dependent for his or her use or benefit. Do not include the cost of a capital item for the household or for use by persons other than the dependent.

Children of Divorced or Separated Parents

In general, a dependent must meet the support test explained earlier under **Test 5—Support**. However, the support test for a child of divorced or separated parents is based on special rules that apply only if all of the following requirements are met:

The parents were divorced or legally separated under a decree of divorce or separate maintenance, were separated under a written separation agreement, or lived apart at all times during the last 6 months of the calendar year.

One or both parents provided more than half the child's total support for the calendar year.

One or both parents had custody of the child for more than half the calendar year.

Child is defined earlier under **Test 4—Income**.

Support provided by parents. Support given to a child of a divorced or separated parent by a relative or friend is not included as support given by that parent.

Example. You are divorced. During the whole year, you and your child lived with your mother in a house she owns. The fair rental value of the home provided by your mother for your child is not included in the support you gave.

Remarried parent. If you remarried, the support your new spouse gave is treated as given by you.

Example. You have two children from a former marriage who lived with you. You remarried and lived in a home owned by your present spouse. The fair rental value of the home provided to the children by your present spouse is treated as provided by you.

Exceptions. This discussion does not apply in any of the following situations:

A third party, such as a relative or friend, gave half or more of the child's support.

The child was in the custody of someone other than the parents for half the year or more.

The child's support is determined under a multiple support agreement.

The parents were separated under a written separation agreement, or lived apart, but they file a joint return for the tax year.

The child is not the child of the divorced or separated parents.

In these situations, support is determined under the regular method discussed earlier under *Test 5—Support*.

Custodial Parent

Under the special rule, the parent who had custody of the child for the greater part of the year is generally treated as the parent who gave more than half the child's support. This parent is usually allowed to claim the exemption for the child, if the other dependency tests are met. However, see *Noncustodial Parent*, later.

Custody. Custody is usually determined by the most recent decree of divorce or separate maintenance, or a later custody decree. If there is no decree, use the written separation agreement. If neither a decree nor agreement establishes custody, then the parent who had physical custody of the child for the greater part of the year is considered the custodial parent. This also applies if the validity of a decree or agreement awarding custody is uncertain because of legal proceedings pending on the last day of the calendar year.

If the parents were divorced or separated during the year, after having had joint custody of the child before the separation, the parent who had custody for the greater part of the rest of the year is considered the custodial parent for the tax year.

Example 1. Under your divorce decree, you have custody of your child for 10 months of the year. Your former spouse has custody for the other 2 months. You and your former spouse provided the child's total support. You are considered to have given more than half the child's support.

Example 2. You were separated on June 1. Your child's support for the year was \$1,200, of which you gave \$500, your spouse \$400, and the child's grandparents \$300. No multiple support agreement was entered into. (See *Multiple Support Agreement*, later.) Before the separation, you and your spouse had joint custody of your child. Your spouse had custody from June through September and you had custody from October through December. Because your spouse had custody for 4 of the 7 months following the separation, your spouse was the custodial parent for the year and is treated as having given more than half the child's support for the year.

Noncustodial Parent

The parent who did not have custody, or who had it for the shorter time, is treated as the parent who gave more than half the child's support if:

- 1) The custodial parent signs a statement agreeing not to claim the child's exemption, and the noncustodial parent attaches this statement to his or her return (see *Form 8332*, later), or
- 2) A decree or written agreement made before 1985 provides that the noncustodial parent can take the exemption and he or she gave at least \$600 for the child's support during the year, unless the pre-1985 decree or agreement was modified after 1984 to specify that this provision will not apply.

Example 1. Under your 1983 divorce decree, your former spouse has custody of your child. The decree states that you can claim the child's exemption. You gave \$1,000 of your child's support during the year and your spouse gave the rest. You are considered to have given over half the child's support, even if your former spouse gave more than \$1,000.

Example 2. Under your 1988 written separation agreement, your spouse has custody of your child. The agreement states that you can claim the child's exemption. If you meet the requirements,

you are considered to have given over half the child's support.

Example 3. Your divorce decree gives custody of your child to your former spouse. It does not say who can claim the child's exemption. If the requirements are met, your former spouse is considered to have given over half the child's support, unless he or she agrees not to claim the child's exemption on *Form 8332* or similar statement.

Form 8332. The custodial parent can sign *Form 8332, Release of Claim to Exemption for Child of Divorced or Separated Parents*, or similar statement, agreeing not to claim the child's exemption. The exemption may be released for a single year, for a number of specified years (for example, alternate years), or for all future years. *Form 8332* presently cannot be revoked.

If you are the noncustodial parent, you must attach the release to your return. If the exemption is released for more than one year, you must attach the original release to your return the first year and a copy each following year.

Post-1984 agreement. If your divorce decree or separation agreement made after 1984 states that you can claim the child as your dependent, you can attach to your return copies of the following pages from the decree or agreement instead of *Form 8332*:

The cover page (write the other parent's social security number on this page),

The page that states you can claim the child as your dependent, and

The signature page showing the date of the agreement.

Pre-1985 agreement. If you are a noncustodial parent who claims a child's exemption under a decree or agreement made before 1985, you must give at least \$600 for that child's support. Check the box on line 6d of your *Form 1040* or line 3d of your *Form 1040A*.

Child support. Child support payments received from the noncustodial parent are considered used for the child's support, even if actually spent on things other than support.

Example. Your 1982 divorce decree requires you to pay child support to the custodial parent and states that you can claim your child's exemption. The custodial parent put the \$1,000 child support you paid during the year into a savings account for the child instead of using it for support. Because your payments are considered used for support, you are considered to have given over half the child's support.

Back child support. Even if you owed child support for an earlier year, your payments are considered support for the year paid, up to the amount of your required child support for that year. If you paid back child support by paying more than the amount required for the year paid, the back child support is not considered support for either the year paid or the earlier year.

Example. Your 1981 divorce decree requires you to pay \$800 child support each year and allows you to claim your child's exemption. Last year you paid only \$500 but made up the \$300 you owed by paying \$1,100 this year. Because you did not pay at least \$600 last year, you cannot take the exemption unless the custodial parent signs a *Form 8332* or similar statement. The \$300 back child support you paid this year is not considered support for last year or for this year.

Medical Expenses

A child of divorced or separated parents whose support test is based on the special rules described in this section is treated as a dependent of both parents for the medical expense deduction. Thus, a parent can deduct medical expenses he or she paid for the child even if an exemption for the child is claimed by the other parent.

Multiple Support Agreement

Sometimes two or more people together pay over half a dependent's support, but no one alone pays over half. One of those people can claim an exemption for the dependent if all the following requirements are met.

The person paid over 10% of the dependent's support.

If not for the support test, the person could claim the dependent's exemption.

The person attaches to his or her tax return a signed *Form 2120, Multiple Support Declaration*, from every other person who meets the previous two requirements. This form states that the person who signs it will not claim the dependent's exemption for that year.

Alimony

Alimony is a payment to or for a spouse or former spouse under a divorce or separation instrument. It includes **separate maintenance payments**.

Alimony is deductible by the payer, and must be included in the spouse's or former spouse's income. Although this discussion is generally written for the payer of the alimony, the recipient can use the information to determine whether an amount received is alimony.

To be alimony, a payment must meet certain requirements. Different requirements apply to payments under instruments executed after 1984 and to payments under instruments executed before 1985. These requirements are discussed later.

Spouse or former spouse. Unless otherwise stated in the following discussions about alimony, the term "spouse" includes "former spouse."

Divorce or separation instrument. The term "divorce or separation instrument" means:

A decree of divorce or separate maintenance or a written instrument incident to that decree,

A written separation agreement, or

A decree or any type of court order requiring a spouse to make payments for the support or maintenance of the other spouse, including a temporary decree, an interlocutory (not final) decree, and a decree of alimony pendente lite (while awaiting action on the final decree or agreement).

Invalid decree. Payments under a divorce decree can be alimony even if the decree's validity is questioned. A divorce decree is valid for tax purposes until a court having proper jurisdiction holds it as invalid.

Amended instrument. An amendment to a divorce decree may change the nature of your payments. Amendments are not ordinarily retroactive for federal tax purposes. However, an amendment to a divorce decree to reflect the original intent of the court will generally be given retroactive effect for federal tax purposes.

Example 1. A court order corrected a mathematical error under your divorce decree to express the original intent to spread the payments over more than 10 years. This change is given retroactive effect for federal tax purposes.

Example 2. Your original divorce decree did not fix any part of the payment as child support. To reflect the true intention of the court, a court order corrected the error by designating a part of the payment as child support. The amended order is given retroactive effect for federal tax purposes.

Deducting alimony paid. You can deduct alimony you paid, whether or not you itemize deductions on your return. Enter the alimony on line 29

Form 1040. You cannot use Form 1040A or Form 1040EZ. In the space on line 29, enter your spouse's or your spouse's last name, if different from yours, and your social security number. If you do not, you may be penalized a \$50 penalty and your deduction may be disallowed.

Alimony received. Report alimony received on line 11 of Form 1040. You cannot use Form 1040A or Form 1040EZ. You must give the person who paid the alimony your social security number. If you do not, you may be penalized a \$50 penalty.

General Rules

The following rules apply to alimony regardless of whether the divorce or separation instrument was executed.

Payments not alimony. Not all payments under a divorce or separation instrument are alimony. Alimony does not include:

- Child support,
- On-cash property settlements,
- Payments that are your spouse's part of community income, as explained later under *Community Property*,
- Use of property, or
- Payments to keep up the payer's property.

Example. Under your written separation agreement, your spouse lives rent-free in a home you own and you must pay the mortgage, real estate taxes, insurance, repairs, and utilities for the home. Because you own the home and the debts are yours, your payments for the mortgage, real estate taxes, insurance, and repairs are not alimony. Neither is the value of your spouse's use of the home.

If the payments otherwise qualify, you can deduct the payments for utilities as alimony. Your spouse must report them as income. If you itemize deductions, you can deduct the real estate taxes and include the interest on the mortgage in figuring your deductible interest.

Child support. To determine whether a payment is child support, see the separate discussion under *Instruments Executed After 1984*. Instruments Executed Before 1985, later, both alimony and child support payments are paid for by your divorce or separation instrument, and you pay less than the total required, the payments apply first to child support then to alimony.

Example. Your divorce decree calls for you to pay your former spouse \$200 a month as child support and \$150 a month as alimony. If you pay a total amount of \$4,200 during the year, you can deduct \$1,800 as alimony and your former spouse must report \$1,800 as alimony received. If you pay \$3,600 during the year, \$2,400 is child support. You can deduct only \$1,200 as alimony. Your former spouse must report \$1,200 as alimony received.

Voluntary payments. Alimony does not include payments not required by a divorce or separation instrument.

Payments to a third party. Payments to a third party on behalf of your spouse under the terms of a divorce or separation instrument may be alimony, if they otherwise qualify. This includes payments for your spouse's medical expenses, living costs (rent, utilities, etc.), taxes, tuition. The payments are treated as received by your spouse and then paid to the third party.

Example 1. Under your divorce decree, you must pay your former spouse's medical and dental expenses. If the payments otherwise qualify, you deduct them as alimony on your return. Your former spouse must report them as alimony

received, and can include them in figuring deductible medical expenses.

Example 2. Under your separation agreement, you must pay the real estate taxes, mortgage payments, and insurance premiums on a home owned by your spouse. If they otherwise qualify, you can deduct the payments as alimony on your return and your spouse must report them as alimony received. If itemizing deductions, your spouse can deduct the real estate taxes and also include the interest on the mortgage in figuring deductible interest.

Life insurance premiums. Premiums you must pay under your divorce or separation instrument for insurance on your life qualify as alimony to the extent your spouse owns the policy.

Payments for jointly-owned home. If your divorce or separation instrument states that you must pay expenses for a home owned by you and your spouse, some of your payments may be alimony.

Mortgage payments. If you must make all the mortgage payments (principal and interest) on a jointly-owned home, and they otherwise qualify, you can deduct one-half of the total payments as alimony. If you itemize deductions, you can include the other half of the interest in figuring your deductible interest. Your spouse must report one-half the payments as alimony received and, if itemizing deductions, can include one-half the interest on the mortgage in figuring deductible interest.

Taxes and insurance. If you must pay all the real estate taxes or insurance on a home held as **tenants in common**, you can deduct one-half of these payments as alimony. Your spouse must report one-half of these payments as alimony received. If you and your spouse itemize deductions, you can each deduct one-half the real estate taxes.

If your home is held as **tenants by the entirety** or **joint tenants with the right of survivorship**, none of your payments for taxes or insurance are alimony. But if you itemize deductions, you can deduct all the real estate taxes.

Instruments Executed After 1984

The following rules for alimony apply to payments under divorce or separation instruments executed after 1984. They also apply to payments under pre-1985 instruments that have been changed to specify that these rules will apply. For the rules for alimony payments under other pre-1985 instruments, see *Instruments Executed Before 1985*, later.

A divorce or separation instrument executed after 1984 will be treated as executed before 1985 if it includes without change the terms for alimony under a pre-1985 instrument. A change in the terms for alimony includes a change in the amount or period of payment, and the addition or deletion of any contingencies or conditions.

Example 1. In November 1984, you and your former spouse executed a written separation agreement. In February 1985, a decree of divorce was entered in substitution for the written separation agreement. The decree of divorce did not change the terms for the alimony you pay your former spouse. The decree of divorce is treated as executed before 1985. Therefore, alimony payments under the decree are subject to the rules for payments under pre-1985 instruments.

Example 2. Assume the same facts as in Example 1 except that the decree of divorce changed the amount of the alimony. In this example, the decree of divorce is not treated as executed before 1985. Therefore, the alimony payments are subject to the rules for payments under instruments executed after 1984.

Alimony Requirements

A payment to or for a spouse under a divorce or separation instrument is alimony if the spouses do not file a joint return and all the following requirements are met:

The payment is in cash.

The instrument does not designate the payment as not alimony.

If the spouses are separated under a decree of divorce or separate maintenance, they are not members of the same household when the payment is made.

There is no liability to make any payment (in cash or property) after the death of the recipient spouse.

The payment is not treated as child support.

For instruments executed in 1985 or 1986, the minimum term rule is met.

Each of these requirements is discussed below.

Payment must be in cash. Only cash payments, including checks and money orders, qualify as alimony. Transfers of services or property (including a debt instrument of a third party or an annuity contract), execution of a debt instrument, or the use of property do not qualify as alimony.

Payments to a third party. Cash payments to a third party under the terms of your divorce or separation instrument can qualify as a cash payment to your spouse. See *Payments to a third party* under *General Rules*, earlier.

Also, cash payments made to a third party at the written request of your spouse qualify as alimony if both the following requirements are met:

The written request states that both spouses intend the payments to be treated as alimony.

You receive the written request from your spouse before you file your return for the year you made the payments.

Payments designated as not alimony. You and your spouse may designate that otherwise qualifying payments are not alimony by including a provision in your divorce or separation instrument that the payments are not deductible by you and are excludable from your spouse's income. For this purpose, any writing signed by both of you that makes this designation and that refers to a previous written separation agreement is treated as a written separation agreement. If you are subject to temporary support orders, the designation must be made in the original or a subsequent temporary support order.

To exclude the payments from income, your spouse must attach a copy of the instrument designating them as not alimony to his or her return for each year the designation applies.

Spouses cannot be members of the same household. Payments to your spouse while you are members of the same household are not alimony if you are separated under a decree of divorce or separate maintenance. A home you formerly shared is considered one household, even if you physically separate yourselves in the home.

You are not treated as members of the same household if one of you is preparing to leave the household, and does leave not more than one month after the date of the payment.

Exception. This rule does not apply if the payments are made under a written separation agreement, support decree, or other court order and you do not have a decree of divorce or separate maintenance.

Liability for payments after death of recipient spouse. If you must continue to make payments for any period after your spouse's death, none of the payments made before or after the death are alimony.

The divorce or separation instrument does not have to expressly state that the payments cease upon the death of your spouse if, for example, the

liability for continued payments would end under state law.

Example. You must pay your former spouse \$10,000 in cash each year for 10 years. Your divorce decree states that the payments will end upon your former spouse's death. You must also pay your former spouse or your former spouse's estate \$20,000 in cash each year for 10 years.

The \$10,000 annual payments are alimony. But because the \$20,000 annual payments will not end upon your former spouse's death, they are not alimony.

Substitute payments. If you must make any payments in cash or property after your spouse's death as a substitute for continuing otherwise qualifying payments, the otherwise qualifying payments are not alimony. Payments may be considered substitute payments, depending on the facts and circumstances, to the extent that any payments are to begin, increase in amount, or become accelerated in time as a result of your spouse's death.

Example 1. Under your divorce decree, you must pay your former spouse \$30,000 annually. The payments will stop at the end of 6 years or upon your former spouse's death, if earlier.

Your former spouse has custody of your minor children. The decree provides that if any of those children are still minors at your spouse's death, you must pay \$10,000 annually to a trust until the youngest child reaches the age of majority. The trust income and corpus (principal) are to be used for your children's benefit.

These facts indicate that the payments to be made after your former spouse's death are a substitute for \$10,000 of the \$30,000 annual payments. Therefore, \$10,000 of each of the \$30,000 annual payments is not alimony.

Example 2. Under your divorce decree, you must pay your former spouse \$30,000 annually. The payments will stop at the end of 15 years or upon your former spouse's death, if earlier. The decree provides that if your former spouse dies before the end of the 15-year period, you must pay the estate the difference between \$450,000 (\$30,000 × 15) and the total amount paid up to that time. For example, if your spouse dies at the end of the tenth year, you must pay the estate \$150,000 (\$450,000 - \$300,000).

These facts indicate that the lump-sum payment to be made after your former spouse's death is a substitute for the full amount of the \$30,000 annual payments. Therefore, none of the annual payments are alimony. The result would be the same if the payment required at death were to be discounted by an appropriate interest factor to account for the prepayment.

Child support. A payment that is fixed or treated as fixed as child support under your divorce or separation instrument is not alimony. A payment is fixed as child support if your instrument specifically designates an amount or part of the payment as support for your child. The designated amount or part may vary from time to time.

A payment will be **treated as fixed** as child support if the payment is reduced either:

On the happening of a contingency relating to your child, or

At a time that can be clearly associated with the contingency.

A payment may be treated as fixed as child support even if other separate payments are specifically designated as child support.

Contingency relating to your child. A contingency relates to your child if it depends on any event relating to that child. It does not matter whether the event is certain or likely to occur. Events relating to your child include the child:

Reaching a specified age or income level,
Dying,
Marrying,

Leaving school,
Leaving the household, or
Becoming employed.

Clearly associated with a contingency.

Payments are presumed to be reduced at a time clearly associated with the happening of a contingency relating to your child only in the following situations:

The payments are to be reduced not more than 6 months before or after the date the child will reach 18, 21, or local age of majority.

The payments are to be reduced on two or more occasions that occur not more than one year before or after a different child reaches a certain age from 18 to 24. This certain age must be the same for each child, but need not be a whole number of years.

In all other situations, reductions in payments are not treated as clearly associated with the happening of a contingency relating to your child.

Either you or the Internal Revenue Service may defeat the presumption in the two situations above. This is done by showing that the time at which the payments are to be reduced was determined independently of any contingencies relating to your children. For example, you can defeat the presumption by showing that alimony payments are to be made for a period customarily provided in the local jurisdiction, such as a period equal to one-half the duration of the marriage.

Minimum term rule. This rule applies only to payments made under a decree of divorce or separate maintenance, or a written separation agreement, executed in 1985 or 1986. Under this rule, the part of an annual payment that is more than \$10,000 is not alimony unless payments will be made for at least 6 consecutive calendar years beginning with the first year alimony is paid.

To determine the first year alimony was paid, disregard payments under a support decree or other court order. Consider only payments qualifying as alimony under a decree of divorce or separate maintenance, or a written separation agreement. In determining whether a payment will be made in any future year, ignore the possible termination of payments because of a contingency (other than the passage of time) that has not yet happened, unless the contingency causes part of the payment to be treated as child support.

Example. Under your divorce decree, you must pay your former spouse \$20,000 in each of the 5 calendar years 1986 through 1990. You are to make no payment in 1991.

Under the minimum term rule, only \$10,000 of each annual payment will be alimony. If the divorce decree also required you to pay \$1 in 1991, the full \$20,000 annual payments would be alimony.

Recapture Rule

The recapture rule changes the tax treatment of past payments by requiring you to include previously deducted alimony in income. It also allows your spouse, who previously included the alimony in income, to deduct the recaptured amount.

The recapture rule may apply if alimony payments are reduced or terminated during the first 3 calendar years. These 3 years start with the first calendar year you make a payment qualifying as alimony under a decree of divorce or separate maintenance, or a written separation agreement. Do not take into account payments under a support decree or other court order. The second and third years are the next 2 calendar years, whether or not payments are made during those years.

The reasons for a reduction or termination of alimony payments can include:

A failure to make timely payments,
A change in your instrument,
A reduction in your spouse's support needs, or

A reduction in your ability to provide support.

Exceptions. The recapture rule does not apply unless your annual alimony payments decrease by more than certain dollar amounts (floors). For instruments executed after 1986, the floor is \$15,000. For instruments executed in 1985 or 1986, the floor is \$10,000.

You do not have to recapture any of the following payments, regardless of their amount:

Payments under a temporary support order before your divorce or separation,

Payments required over a period of at least 3 calendar years of a fixed part of your income from a business or property, or from compensation for employment or self-employment, or

Payments that end because you or your spouse dies or your spouse remarries within the first 3 calendar years of payments.

Including the recapture in income. If you must include a recapture amount in income, show it on Form 1040, line 11 ("Alimony received"). Cross out "received" and write "recapture." On the dotted line next to the amount, enter your spouse's last name and social security number.

Deducting the recapture. If you can deduct a recapture amount, show it on Form 1040, line 29 ("Alimony paid"). Cross out "paid" and write "recapture." In the space provided, enter your spouse's last name and social security number.

Instruments executed after 1986. This recapture rule applies to payments under divorce or separation instruments executed after 1986. It also applies to payments under pre-1987 instruments that have been changed to specify that the 1986 Tax Reform Act changes will apply.

Alimony paid under these instruments during both the first and second calendar years is subject to recapture in the third calendar year. For example, if you first paid alimony in 1987, your payments during 1987 and 1988 are subject to recapture on your 1989 return.

Both you and your spouse can use the worksheet at the end of this publication to figure recaptured alimony.

Example. Myrna pays Phil the following amounts of alimony under their 1987 divorce decree.

Year	Amount
1987	\$60,000
1988	40,000
1989	20,000

A filled-in *Worksheet for Recapture of Alimony* is shown on the next page.

Myrna shows \$22,500 as income on line 11 of her 1989 Form 1040. Phil deducts \$22,500 on line 29 of his 1989 Form 1040.

Instruments executed in 1985 or 1986. This recapture rule applies to payments under divorce or separation instruments executed in 1985 or 1986 (or pre-1985 instruments changed to include the tax changes made by the Tax Reform Act of 1984) and not changed to specify that the 1986 Tax Reform Act changes are to apply.

Alimony paid under these instruments is subject to recapture in both the second and third calendar years (the computation year). If the alimony you paid in the computation year is more than \$10,000 less than the alimony you paid in any earlier calendar year, you must figure the amount to be recaptured for the computation year.

The amount to be recaptured for any computation year is the sum of excess amounts determined for each earlier year. The excess amount is the alimony paid in the earlier year that is more than \$10,000 plus the alimony paid during the computation year.

For this calculation, the alimony paid during any year before the computation year is reduced by

Worksheet for Recapture of Alimony

(For instruments executed after 1986)

Note: Do not enter less than zero on any line.

1. Alimony paid in 2nd year	\$ 40,000	
2. Alimony paid in 3rd year	\$ 20,000	
3. Floor	\$15,000	
4. Add lines 2 and 3	35,000	
5. Subtract line 4 from line 1		\$ 5,000
6. Alimony paid in 1st year	60,000	
7. Adjusted alimony paid in 2nd year (line 1 less line 5)	35,000	
8. Alimony paid in 3rd year	20,000	
9. Add lines 7 and 8	55,000	
10. Divide line 9 by 2	27,500	
11. Floor	\$15,000	
12. Add lines 10 and 11	42,500	
13. Subtract line 12 from line 6		17,500
14. Recaptured alimony. Add lines 5 and 13		\$ 22,500

* If you deducted alimony paid, report this amount as income on line 11, Form 1040.

If you reported alimony received, deduct this amount on line 29, Form 1040.

any excess amount previously determined for that earlier year.

Example. You were divorced in 1986. Your divorce decree has not been changed to specify that the 1986 Tax Reform Act changes are to apply. Your first payment that qualifies as alimony was made in 1987. You paid alimony to your former spouse of \$25,000 in 1987, \$12,000 in 1988, and \$1,000 in 1989.

The excess amount for 1987 that is recaptured in 1988 is \$3,000. [\$25,000 - (\$12,000 + \$10,000)]. For 1989, the amount considered paid in 1987 is \$22,000.

The excess amount that is recaptured in 1989 is \$12,000. This is the sum of an \$11,000 excess amount for 1987 [\$22,000 - (\$1,000 + \$10,000)] and a \$1,000 excess amount for 1988 [\$12,000 - (\$1,000 + \$10,000)].

Instruments Executed Before 1985

The following rules for alimony apply to payments under divorce or separation instruments executed before 1985. However, if your pre-1985 instrument has been changed to specify that the rules for instruments executed after 1984 apply, see the previous discussion.

Alimony Requirements

A payment to or for a spouse under a divorce or separation instrument is alimony if the spouses do not file a joint return and all the following requirements are met.

The payment is periodic instead of a lump sum.

The payment is based on the marital or family relationship.

The payment is not child support.

In addition, the spouses must be separated and living apart for a payment under a separation agreement or court order to qualify as alimony.

Periodic payments. Periodic payments are:

Payments of a fixed amount for an indefinite period (for example, \$400 a month for life),

Payments of an indefinite amount for either a fixed or an indefinite period (for example, 10% of a salary that changes from year to year, to be paid for 6 years), or

Payments of a fixed amount for a fixed period of more than 10 years, subject to a limit.

Indefinite period. Payments are for an indefinite period if they are to end or change in amount on the happening of one or more of the following contingencies:

Your or your spouse's death,

Your spouse's remarriage, or

A change in your or your spouse's economic status.

The contingency may be either specified in your instrument or imposed by local law.

Example. Under your 1984 divorce decree, you must pay your former spouse \$24,000. This amount is to be paid in installments of \$200 a month for 120 months. The payments will stop if your former spouse dies or remarries. Because the payments are subject to those contingencies, they are periodic.

More than 10 years. If you must pay a fixed amount for a fixed period of more than 10 years, the amount of each annual payment considered periodic is limited to 10% of the total you will pay over the entire period. The 10% limit applies to payments made in advance, but not to payments for an earlier period.

Example 1. Your 1984 divorce decree states that you must pay your former spouse \$150,000 in

installments of \$20,000 a year for 6 years and \$5,000 a year for the following 6 years. The payments are not subject to any contingencies. For the first 6 years, only \$15,000 (10% of \$150,000) of each year's payment is considered periodic. The entire \$5,000 you will pay in each of the last 6 years is considered periodic.

Example 2. Your 1984 divorce decree states that you must pay your former spouse \$150,000 in installments of \$10,000 for 15 years. The payments are not subject to any contingencies. You paid \$10,000 each year through 1987, but you made no payment in 1988. In 1989 you paid \$30,000, consisting of \$10,000 for 1988, \$10,000 for 1989, and a \$10,000 advance payment for 1990.

Only \$25,000 of your \$30,000 payment is considered periodic. This is the \$10,000 payment for 1988 and \$15,000 (10% of \$150,000) of the payments for 1989 and 1990.

Marital or family relationship. To be alimony, your payments must be based on your obligation, because of the marital or family relationship, to continue supporting your spouse. Any payment that does not arise out of that support obligation, such as the repayment of a loan, is not alimony.

Property settlement. Payments are not based on your obligation to continue support if they are a settlement of property rights. However, even if a state court describes payments made under a divorce decree as payments for property rights, they are alimony if they are made to fulfill a legal support obligation and they otherwise qualify.

Child support. A payment that is fixed as child support under your divorce or separation instrument is not alimony. If the instrument calls for payments that otherwise qualify as alimony and does not fix an amount as child support, all the payments are alimony. This is true even if the payments are subject to a contingency relating to your child.

Example. Your divorce decree states that you must pay your former spouse \$400 a month for life for the support of your former spouse and your child. The payment is to be reduced to \$300 upon the first of the following to happen: the child's death, the child's 22nd birthday, or the child's marriage. Despite these contingencies, no amount of child support is fixed by the decree. Therefore, the entire payment is alimony.

Alimony Trusts, Annuities, and Endowment Contracts

If you transferred property to a trust or bought or transferred an annuity or endowment contract to pay the alimony you owe, the proceeds must be included in your spouse's income as alimony received. You do not include the payments in your income, nor can you deduct them as alimony paid. This rule applies whether the proceeds are from the earnings or the principal of the transferred property.

Example. You are required to make monthly alimony payments of \$500. You bought your former spouse a commercial annuity contract paying \$500 a month. Your former spouse must include the full amount received under the contract in income, as alimony. It does not matter whether the amount is paid out of principal or interest. You do not include any part of the payment in your income, nor can you deduct any part.

Annuity and endowment contracts. Proceeds from annuity and endowment contracts bought for or transferred to a spouse after July 18, 1984, cannot be treated as alimony. However, this does not apply to contracts bought or transferred to pay alimony under a divorce or separation instrument executed on or before July 18, 1984, unless both spouses choose to have it apply. For information on how to make this choice, see Section 1041 election under *Property Settlements*, later.

Proceeds not alimony. If the proceeds from an annuity or endowment contract cannot be treated as alimony, the amount received is reduced by the cost of the contract. See Publication 575, *Pension and Annuity Income (Including Simplified General Rule)*, for information on reporting annuities, and Publication 525, *Taxable and Nontaxable Income*, for information on reporting endowment proceeds.

If the proceeds from a trust cannot be treated as alimony, see the rules for reporting trust income in Publication 525.

Individual Retirement Arrangements

If you get a final decree of divorce or separate maintenance by the end of your tax year, you cannot deduct contributions you make to your former spouse's individual retirement arrangement (IRA). You can deduct only contributions to your own IRA. For information on IRAs, see Publication 590, *Individual Retirement Arrangements (IRAs)*.

IRA transferred as a result of divorce. The transfer of your interest in an IRA to your former spouse, under your divorce decree or written instrument incident to your divorce, is not considered a taxable transfer. Starting from the date of the transfer, the IRA is treated as your former spouse's IRA.

Caution. As this publication was being prepared for print, Congress was considering legislation that would make the transfer of your interest in an IRA to either your spouse or former spouse nontaxable, if made under a decree of divorce or separate maintenance or a written instrument incident to that decree. For additional information on any late legislative changes, get Publication 553, *Highlights of 1989 Tax Changes*.

IRA deduction limit. All taxable alimony you receive under a decree of divorce or separate maintenance is treated as compensation for the IRA deduction limit. If you are not covered by an employer retirement plan, you can deduct contributions to your IRA equal to the least of the following amounts:

- \$2,000,
- 100% of your compensation, or
- Your actual contributions to the IRA for the year.

If you are covered by an employer retirement plan, your deduction for contributions to your IRA may be reduced or eliminated.

Rollovers

A rollover is a tax-free distribution of cash or other assets from one retirement program to another. You cannot deduct a rollover on your tax return.

Distributions under divorce or similar proceedings. You can make a tax-free rollover into an IRA of all or part of a distribution you receive from your spouse's or former spouse's qualified employee benefit plan because of a divorce or similar proceeding if the distribution is:

- The balance to your credit in the plan,
- Made under a **qualified domestic relations order**,
- Received within one tax year (your tax year, not the plan's year), and
- Rolled over within 60 days after you receive it.

For a distribution of property other than money, you must roll over the same property you received from the plan.

Qualified domestic relations order. A "domestic relations order" is a judgment, decree, or court order, including an approved property settlement agreement, that is issued under the domestic relations law of a state. A "qualified domestic relations order" gives a spouse, former spouse, child, or dependent of a participant in a retirement plan the right to receive all or part of the benefits that would be payable to the participant under the plan. The order must contain certain specific information and may not change the amount or form of the plan's benefits.

Amounts not rolled over. If you roll over only part of the distribution, the amount you keep must be included in income in the year you receive it. Reduce this amount by a prorated share of the participant's cost (investment in contract). The special rules for lump-sum distributions (special averaging method or capital gain treatment) may apply. However, the 10% additional tax on premature distributions does not apply. For more information, see Publication 575, *Pension and Annuity Income (Including Simplified General Rule)*.

Property Settlements

The following discussion explains the income tax treatment of transfers of property between spouses (whether or not separation or divorce occurs at any time), and between former spouses if incident to divorce. These rules do not apply to transfers of property to a spouse or former spouse who is a nonresident alien.

Incident to divorce. A property transfer is incident to a divorce if the transfer occurs within one year after the date the marriage ends, or if the transfer is related to the ending of the marriage. A divorce, for this purpose, includes the ending of the marriage by annulment or due to violations of state laws.

Related to the ending of the marriage. A property transfer is related to the ending of a marriage if both the following conditions apply.

- The transfer is made under an original or modified divorce or separation instrument.
- The transfer occurs within 6 years after the date the marriage ends.

Unless these conditions are met, the transfer is presumed not to be related to the ending of the marriage. However, this presumption will not apply if you can show that the transfer was made to carry out the division of property owned by the spouses at the time the marriage ended. For example, the presumption will not apply if you can show that the transfer was made more than 6 years after the end of the marriage because of business or legal factors which prevented earlier transfer of the property.

Property transferred. The term "property" includes all property whether real or personal, tangible or intangible, or separate or community property. It includes property acquired after the end of the marriage and transferred to a former spouse. It does not include services.

The transfer may be a gift or an arm's-length sale or exchange. It may be direct or in trust for the benefit of the spouse or former spouse.

No gain or loss. No gain or loss is recognized on the transfer of property between spouses or former spouses. This applies even if the transfer was in exchange for cash, the release of marital rights, the assumption of liabilities, or other considerations.

Transfers in trust. Gain on a transfer of property in trust is recognized to the extent that the sum of the liabilities assumed by the trust, plus the liabilities to which the property is subject, is more than the total of the adjusted basis of the property transferred. Also, gain or loss is recognized on a transfer in trust of an installment obligation. For information on the disposition of an installment obligation, see Publication 537, *Installment Sales*.

Example. You own property with a fair market value of \$10,000 and an adjusted basis of \$1,000. The property is subject to a \$5,000 liability. Your recognized gain on the transfer of the property in trust to your spouse is \$4,000 (\$5,000 - \$1,000).

U.S. savings bonds. If a U.S. savings bond is transferred, the transferor must include in income all interest on the bond that has been earned up to the date of transfer but not previously reported. Interest earned after the transfer is included in the income of the bond's recipient. See Publication 550, *Investment Income and Expenses*, for more information.

Tax treatment of property received. Property received from a spouse or former spouse is treated as acquired by gift and, therefore, its value is not taxable.

Basis. The recipient's basis in the property is the same as the transferor's adjusted basis. This applies for determining either gain or loss when the recipient later disposes of the property. It applies whether the property's adjusted basis is less than, equal to, or greater than either its value at the time of the transfer or any consideration paid by the recipient. It also applies even if the property's liabilities are more than its adjusted basis.

Basis of property transferred in trust. If the transferor recognizes gain on property transferred in trust, as described earlier under *No gain or loss*, the trust's basis in the property is increased by the recognized gain.

Example. Your spouse transfers property to you in trust, recognizing a \$4,000 gain. Your spouse's adjusted basis in the property was \$1,000. The trust's basis in the property is \$5,000 (\$1,000 + \$4,000).

Basis in U.S. savings bonds. The recipient's basis in U.S. savings bonds transferred is increased by the interest included in the transferor's income, as described earlier under *U.S. savings bonds*.

Investment credit property. If the transferor was allowed an investment credit on the transferred property, the recipient is subject to recapture of the credit if, after the transfer, the property is not used as investment credit property or is disposed of. For more information, see Publication 572, *General Business Credit*.

Transfers to third parties. These rules apply to a transfer of property to a third party on behalf of a spouse or former spouse in the following situations.

The transfer is required by a divorce or separation instrument.

The transfer follows a written request of the recipient spouse or former spouse.

The recipient spouse or former spouse gives the transferor written consent to transfer the property. This consent must state that the parties intend the transfer to be treated as a transfer to the recipient spouse or former spouse under these rules. This must be received by the transferor before filing the tax return for the year the transfer was made.

In these situations the property is treated as transferred directly to the recipient spouse or former spouse and then immediately transferred to the third party. This transfer to the third party may result in gain or loss to the recipient spouse or former spouse.

Record requirements. At the time of the property transfer, the transferor must give the recipient sufficient records to determine the adjusted basis and holding period of the property on the date of the transfer. If the property could be subject to recapture of investment credit, the transferor also must provide sufficient records to determine the amount and period of the recapture.

Section 1041 election. These rules apply to all transfers after July 18, 1984. However, these rules apply to transfers made under instruments in effect on or before July 18, 1984, only if both parties choose to have them apply. If this choice is made, these rules will apply to all property transferred under the instrument.

To make this choice, both spouses or former spouses must sign and include their social security numbers on a statement. This statement must be attached to the first income tax return filed by the transferor for the tax year the first transfer occurs. A copy of the signed statement must be kept by both parties, and a copy must be attached to the transferor's return for each later tax year in which a transfer is made under the election.

The following is an example of an acceptable statement.

Section 1041 Election

The undersigned hereby elect to have the provisions of section 1041 of the Internal Revenue Code apply to all qualifying transfers of property after July 18, 1984, under any instrument in effect on or before July 18, 1984. The undersigned understand that section 1041 applies to all property transferred between spouses, or former spouses incident to divorce. The parties further understand that the effects for federal income tax purposes of having section 1041 apply are that (1) no gain or loss is recognized by the transferor spouse or former spouse as a result of this transfer; and (2) the basis of the transferred property in the hands of the transferee is the adjusted basis of the property in the hands of the transferor immediately before the transfer, whether or not the adjusted basis of the transferred property

is less than, equal to, or greater than its fair market value at the time of the transfer. The undersigned understand that if the transferee spouse or former spouse disposes of the property in a transaction in which gain is recognized, the amount of gain which is taxable may be larger than it would have been if this election had not been made.

Gift Tax on Property Settlements

A transfer of property in exchange for the release of marital rights is generally subject to gift tax. The transferor must report the transfer on a gift tax return for the calendar year the transfer was made. See Form 709, later.

The release of marital rights is the giving up by one spouse of dower, curtesy, or other marital rights in the other spouse's property or estate. This does not include the release of spousal or child support rights. The transfer of property in exchange for support rights is not subject to gift tax.

If property is transferred for the release of both marital and support rights, the transfer is subject to gift tax to the extent the value of the property is more than the value of the support rights given up.

Transfers of property in exchange for the release of marital rights are not subject to gift tax if they meet any of the following exceptions.

They qualify for the annual exclusion.

They qualify for the marital deduction.

They are required by a divorce decree.

The spouses are divorced within a specified period.

Annual exclusion. The first \$10,000 of gifts of present interests to any person during the calendar year is not subject to gift tax. The annual exclusion is \$100,000 for transfers after July 13, 1988, to a spouse who is not a U.S. citizen.

Marital deduction. A transfer of property to a spouse before receiving a final decree of divorce or separate maintenance is not subject to gift tax. However, this rule does not apply to:

Transfers of certain terminable interests.

Transfers after July 13, 1988, to a spouse who is not a U.S. citizen, or

Transfers by a nonresident alien.

See the instructions for Form 709 for more information.

Transfer under divorce decree. A transfer of property under the decree of a divorce court having the power to prescribe a property settlement is not subject to gift tax. This rule also applies to a property settlement agreed on before the divorce if it was made part of or approved by the decree.

Divorce within specified period. A transfer of property under a written agreement in exchange for the release of marital rights is not subject to gift tax if the spouses are divorced within the 3-year period beginning one year before and ending 2 years after the date of the agreement. This applies whether or not the agreement is part of or approved by the divorce decree.

Form 709. A transfer of property subject to gift tax must be reported on Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return*. Generally, Form 709 is due April 15 following the year of the transfer.

Divorce within specified period. If a property transfer would be subject to gift tax except for the rules for divorce within a specified period, and a final decree of divorce is not granted by the due date for filing the gift tax return, you must report the transfer on Form 709 and attach a copy of

your written agreement. The transfer will be treated as not subject to the gift tax until the final decree of divorce is granted, but no longer than 2 years after the effective date of the written agreement.

Within 60 days after a final decree of divorce is granted, send a certified copy of the decree to the IRS office where you filed Form 709.

Sale of Jointly-Owned Property

If you sell property that you and your spouse own jointly, you must report your share of the gain or loss on your income tax return for the year of the sale. Your share of the gain or loss is determined by your state law governing ownership of property. For information on reporting gain or loss, see Publication 544, *Sales and Other Dispositions of Assets*.

Sale of home. If you sell your main home and buy a new one, you may be able to postpone paying the tax on some or all of any gain from the sale. If you and your spouse have agreed to live apart and sell your jointly-owned home, the rules for postponing tax can apply separately to the gain realized by each of you. For information on these rules, and on the rules for excluding gain if you are 55 or older when you sell your home, see Publication 523, *Tax Information on Selling Your Home*.

Costs of Getting a Divorce

You cannot deduct legal fees and court costs for getting a divorce. But you may be able to deduct legal fees paid for tax advice in connection with divorce and legal fees to get alimony that you must include in gross income.

In addition, you can include fees you pay to appraisers, actuaries, and accountants for services in determining your correct tax or in helping to get alimony.

Fees you pay may include charges that are deductible and charges that are not deductible. You should request a breakdown showing the amount charged for each service performed. You can claim the deductible fees only if you itemize deductions on Schedule A (Form 1040). Claim them as miscellaneous deductions subject to the 2% of adjusted gross income limit. For more information, see Publication 529, *Miscellaneous Deductions*.

Fees for tax advice. You can deduct fees for advice on federal, state, and local taxes of all types, including income, estate, gift, inheritance, and property taxes.

If a fee is also for other services, you must determine and prove the expense for tax advice. The following examples show how you can meet this requirement.

Example 1. The lawyers handling your divorce consult another law firm, which handles only tax matters, to get information on how the divorce will affect your taxes. You can deduct the part of the fee paid over to the second firm and separately stated on your bill, subject to the 2% limit.

Example 2. The law firm handling your divorce uses the firm's tax department for tax matters related to your divorce. Your statement from the firm shows the part of the total fee for tax matters. This is based on the time used, the difficulty of the tax questions, and the amount of tax involved. You can deduct this part of your bill, subject to the 2% limit.

Example 3. The lawyer handling your divorce also works on the tax matters. The fee for tax advice and the fee for other services are shown

on the lawyer's statement. They are based on such things as the time spent on each service and the fees charged locally for similar services. You can deduct the fee charged for tax advice, subject to the 2% limit.

Fees for getting alimony. Because you must include alimony you receive in your gross income, you can deduct legal fees you pay to get or collect alimony.

Example. You pay your attorney a fee for handling your divorce and, in addition, a fee that is for services in getting and collecting alimony. You can deduct the fee for getting and collecting alimony, subject to the 2% limit, if it is separately stated.

Nondeductible expenses. You cannot deduct the costs of personal advice, counseling, or legal action in a divorce. These costs are not deductible, even if they are paid, in part, to arrive at a financial settlement or to protect income-producing property.

However, you can add certain legal fees you pay specifically for a property settlement to the basis of the property you receive. For example, the cost of preparing and filing a deed to put title to your house in your name alone can be added to the basis of the house.

You cannot deduct legal expenses you pay for your spouse, even if they are for tax advice only. If you have no legal responsibility arising from the divorce settlement or decree to pay your spouse's legal fees, your payments are gifts and may be subject to the gift tax.

Tax Withholding and Estimated Tax

When you become divorced or separated, you will usually have to file a new Form W-4, *Employee's Withholding Allowance Certificate*, with your employer to claim your proper withholding allowances. If you receive alimony, you may have to make estimated tax payments.

If you do not pay enough tax either through withholding or by making estimated tax payments, you will have an underpayment of estimated tax and you may have to pay a penalty. If you do not pay enough tax by the due date of each payment, you may have to pay a penalty even if you are due a refund when you file your tax return.

For more information, see Publication 505, *Tax Withholding and Estimated Tax*.

Joint estimated tax payments. If you were divorced during 1989, either you or your former spouse can claim all of your 1989 joint estimated tax payments, or you may divide them in any way you agree on. If you cannot agree, you must divide the payments in proportion to each spouse's individual tax as shown on your separate returns for 1989.

If you claim any of the payments on your tax return, enter your former spouse's social security number in the block provided on the front of Form 1040. If you were divorced and remarried in 1989, enter your present spouse's social security number in the block provided on the front of Form 1040. Also, under the bold heading "Payments" to the left of line 57, write your former spouse's social security number, followed by "DIV."

Withholding on nonresident aliens. If you are a U.S. citizen or resident and you pay alimony to a nonresident alien spouse or former spouse, you must withhold income tax at a rate of 30% (or lower treaty rate) on each payment. For more information, see Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Corporations*.

Community Property

If your domicile (permanent legal home) is in a community property state, special rules determine your income. Some of these rules are explained in the following discussions. For more information, see Publication 555, *Community Property and the Federal Income Tax*.

Community property states. The following are community property states:

Arizona,
California,
Idaho,
Louisiana,
Nevada,
New Mexico,
Texas,
Washington, and
Wisconsin.

Community Income

If your domicile is in a community property state during any part of your tax year, you may have community income. One-half of any income described by state law as community income is included in each spouse's gross income. Each spouse can claim credit for one-half the income tax withheld from community income.

Spouses living apart all year. Special rules apply if all the following conditions exist.

- 1) You and your spouse live apart all year.
- 2) You and your spouse do not file a joint return for a tax year beginning or ending in the calendar year.
- 3) You or your spouse has earned income for the calendar year that is community income.
- 4) You and your spouse have not transferred, directly or indirectly, any of the earned income in (3) between yourselves before the end of the year. Do not take into account transfers satisfying child support obligations or transfers of very small amounts or value.

If all of these conditions exist, you and your spouse must report your **community** income as explained in the following discussions.

Earned income. Treat earned income that is not trade or business or partnership income as the income of the spouse who performed the services to earn the income. Earned income is wages, salaries, professional fees, and other compensation for personal services.

Earned income does not include amounts paid by a corporation that are a distribution of earnings and profits rather than a reasonable allowance for personal services rendered. If capital investment and personal services are combined to produce business income, all of the income is treated as trade or business income and none is treated as earned income.

Trade or business income. Treat income and related deductions from a trade or business that is not a partnership as those of the spouse carrying on the trade or business.

Partnership income or loss. Treat income or loss from a trade or business carried on by a partnership as the income or loss of the spouse who is the partner.

Separate property income. Treat investment income from the separate property of one spouse as the income of that spouse.

Social security benefits. Treat social security and equivalent railroad retirement benefits as the income of the spouse who receives the benefits.

Other income. Treat all other community income, such as dividends, interest, rents, royalties, or gains, as provided under your state's community property law.

Example. George and Sharon were married throughout the year but did not live together at any time during the year. Both were domiciled in a community property state. They did not file a joint return or transfer any of their earned income between themselves. During the year their incomes were as follows:

	George	Sharon
Wage	\$20,000	\$22,000
Consulting business	5,000	
Partnership		10,000
Dividends from separate property	1,000	2,000
Interest from community property	500	500
Totals	\$26,500	\$34,500

Under the community property law of their state, all the income is considered community income. (Some states treat income from separate property as separate income—check your state law.) Sharon did not take part in George's consulting business.

Ordinarily, they would each report \$30,500, half the total community income, on their separate returns. But because they meet the four conditions discussed earlier, they must disregard community property law in reporting all their income except the interest income from community property. They each report on their returns only their own earnings and other income, and their share of the interest income from community property. George reports \$26,500 and Sharon reports \$34,500.

Other separated spouses. If you and your spouse are separated, but do not meet the four conditions discussed earlier under *Spouses living apart all year*, you must treat your income according to the laws of your state.

Your state law determines whether your income is separate or community income. In some states, income earned after separation but before a final decree of divorce continues to be community income. In other states, it is separate income. In some states, the spouses may enter into a legal agreement that any income earned by either of them for personal services is his or her separate income rather than community income.

Ending the community. When the marital community is ended, the community assets (money and property) are divided between the spouses. Income received before the community ended is treated according to the rules explained earlier. Income received after the community ended is separate income, taxable only to the spouse to whom it belongs.

An absolute decree of divorce or annulment ends the community in all community property states. A decree of annulment, even though it holds that no valid marriage ever existed, usually does not nullify community property rights arising during the "marriage." However, you should check your state law for exceptions.

A separation from bed and board ends the community in Louisiana.

A decree of legal separation or of separate maintenance may or may not end the community. The court issuing the decree may terminate the community and divide the property between the spouses.

A separation agreement may divide the community property between you and your spouse. It may provide that this property, along with future earnings and property acquired, will be separate property. Such an agreement may end the community. In some states, the community ends when the spouses permanently separate, even if there is no formal agreement. Check your state law.

Example of community income. John and Mary Smith were domiciled in a community property state for the whole year. Under state law, all earned income of the spouses is community income until they get a final decree of divorce.

John and Mary separated on March 15 and got a final decree of divorce on September 15. John was employed all year, but Mary began working only after the separation. Their gross wages were:

Payday	John	Mary
1/10	\$ 2,000	
2/10	2,000	
3/10	2,000	
4/10	2,000	\$ 626
5/10	2,000	1,250
6/10	2,000	1,250
7/10	2,000	1,250
8/10	2,250	1,250
9/10	2,250	1,250
10/10	2,250	1,250
11/10	2,250	1,250
12/10	2,250	1,250
Totals	\$25,250	\$10,626

These totals are shown on John's and Mary's Forms W-2 for the year. However, these are **not**

the amounts they enter on their tax returns as wages. The correct amounts are as follows:

John's wages before 9/15	\$18,500
Mary's wages before 9/15	6,876
Total community earnings	\$25,376
Half community earnings	\$12,688
John's wages after 9/14	6,750
Amount John reports	\$19,438
Half community earnings	\$12,688
Mary's wages after 9/14	3,750
Amount Mary reports	\$16,438

John and Mary each take credit for one-half the income tax withheld from their wages before September 15.

Both John and Mary should attach to their return a statement showing how they figured the amount they entered on the return and why it is different from the amount on their Forms W-2.

If state law provided that earned income was community income until the date of separation, John would enter on his return \$22,250 gross wages, and Mary would report \$13,626 gross wages.

Alimony

Payments that may otherwise qualify as alimony are not deductible by the payer if they are the recipient spouse's part of community income. They are deductible as alimony only to the extent they are more than that spouse's part of community income.

Example. You live in a community property state. You are separated and your spouse has no income. Under a written agreement, you pay your spouse \$12,000 of your \$20,000 total yearly community income. Under your state law, earnings of a spouse living separate and apart from the other spouse continue as community property. On your separate returns, each of you must report \$10,000 gross income (half of the total community income). In addition, your spouse must report \$2,000 as alimony received on line 11 of Form 1040. You can deduct \$2,000 as alimony paid on line 29 of Form 1040.

Worksheet for Recapture of Alimony

(For instruments executed after 1986)

Note: Do not enter less than zero on any line.

1. Alimony paid in 2nd year		
2. Alimony paid in 3rd year		
3. Floor	\$15,000	
4. Add lines 2 and 3		
5. Subtract line 4 from line 1		
6. Alimony paid in 1st year		
7. Adjusted alimony paid in 2nd year (line 1 less line 5)		
8. Alimony paid in 3rd year		
9. Add lines 7 and 8		
10. Divide line 9 by 2		
11. Floor	\$15,000	
12. Add lines 10 and 11		
13. Subtract line 12 from line 6		
14. Recaptured alimony. Add lines 5 and 13		*

* If you deducted alimony paid, report this amount as income on line 11, Form 1040.

If you reported alimony received, deduct this amount on line 29, Form 1040.

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